



Deficiencies and reform of Algeria's foreign direct investment

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Abstract:

This study analyzed the values of foreign direct investment received in Algeria during 2008-2022; the descriptive analytical approach was the most appropriate for the study's topic.

The study found that Algeria's legal system for managing foreign direct investment had undergone many changes and had been characterized by instability. Numerous laws had been enacted to attract foreign investors, but in fact, those laws had carried with them some limiting freedom of investment and restricting the scope of business.

Foreign direct investment in Algeria increased in 2008/2014 immediately after the application of Ordinance 01/03 on freedom of investment under Algeria's pursuit of the principles of the capitalist economy. However, applying the 51/49 rule led to a perceived decline in foreign direct investment values. It remained relatively stable during 2014/2021, indicating the ineffectiveness of laws enacted to attract foreign investors and improve the investment environment.

Keywords: investment, foreign direct investment, Ordinance 01/03, 51/49 rule.

Jel Classification Codes: F21, F43.

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1. Introduction

Investment is a crucial driver of growth and development, contributing to productive capacity-building, transforming the economy's structure, generating employment positions, and more is an essential source of modern technology transfer and the use of sophisticated production methods and techniques (*Investment and Financial Flows to Address Climate Change*, 2007).

In recent years, foreign direct investment (FDI) polarization has become necessary to keep pace with the significant digital transformations the world is witnessing in the context of the Fourth Industrial Revolution and its accompanying radical changes in production methods such as automation and expansion of robots, the Internet of Things and cloud computing.

Beginning in 2009, Algeria experienced a marked decline in the investment volume received. According to the researchers, this is due to the inflexibility and stability of Algeria's investment system, including laws and weak incentives, benefits, and guarantees to investors.

However, the global digital transformation forced Algeria to revise Algerian foreign investment laws to increase foreign investment flows and thus benefit from the expected gains.

This study analyzed Algeria's investment realities and the legal environment's effectiveness in promoting FDI.

2. Literature review

FDI and its relationship with economic growth have received the attention of researchers from various studies and theories for several decades. According to the new growth theory, FDI is a critical factor contributing to the promotion of recipient countries' economic growth through improved efficiency of technology transfer. In the same context, Neoclassical theories have seen FDI as a vital factor for growth and economic well-being through its extensive use of capital

in developing the host country industry, especially the LDCs, characterized by high unemployment and scarce domestic financial resources (Mbang, 2022). Moreover, for many years, FDI has been a significant conduit for host countries' access to advanced technologies. It thus plays a crucial role in their technological advancement, as it can benefit from the "contagion effect" associated with sophisticated technology, modern management trends, and marketing fundamentals of foreign companies (Berthélemy & Démurger, 2000).

According to OECD, FDI passes on its impact on growth through three channels. The first is the linkages between FDI and foreign trade flows. The second included the indirect external effects on the host country. Finally, the third channel directly impacts structural factors in the host environment (Mbang, 2022) (Ruixue et al., 2015a). Furthermore, OECD Considers that FDI, as well as its technological impacts, also promotes human capital formation, contributes to the integration of international trade, creates a more competitive trading environment, and encourages enterprise development (OECD, 2002) (Chorn & Siek, 2017). Thus, FDI is at the forefront of variables that drive development and reduce unemployment, as acquiring foreign capital and investment enables the country to invest in human and material wealth (Gochero, 2018).

Further, FDI is attracted to a distinct geographical location, a significant advantage in resources, many different industries, and enormous development potential. (Ruixue et al., 2015).

In another view, the FDI strategy improves the trade structure through the flow of composites, production technology, and industrial enterprises. The previous three aspects upgrade the commercial plan (Zhao, 2019).

In the same context, many studies confirm a dual correlation and correlation between FDI and economic growth where they affect each other. FDI tends to directly and positively impact GDP and economic

growth if more resources are funded in education and training, financial markets are developed, and the technology gap between foreign and domestic firms is narrowed. The positive relationship between FDI and growth and foreign resources is more vital than a domestic investment so that FDI can influence GDP through labor productivity (Chien & Zhang, 2012)

However, FDI is more effective if domestic conditions are appropriate in the host country, such as less expensive resources, limited bureaucratic management, and optimization of the host country's skills. This dynamic leads to mutual benefits for the investor as well as the local government of transferring technical knowledge, creating a competitive market for domestic industry, paving the way for other sectors to invest, and above all, enriching the investor's ability to make profits in another country except his own, are some of the reasons for the exponential growth in FDI (Minimol, 2017).

Several studies have tried to ascertain the relationship between FDI and economic growth in econometrics. It reached mixed conclusions that FDI stimulates economic growth in some economic sectors, Most studies have found that there is a positive impact of FDI on economic growth, but provided there is a field of interrelated factors such as an appropriate and stable legal and legislative environment Policy and Security, Real Estate and Tax Incentives, Easy transition of Investment Returns, Sophisticated and Flexible Banking and Financial System (Akpan & Eweke, 2017) (Epaphra & Mwakalasya, 2017) (Tetteh & Gao, 2020).

The world economy has recently experienced a marked boom in FDI flows and balances. In particular, FDI flows to developing economies increased by 2 percent to their highest level in 2014, reaching \$681 billion.

In 2021, most developed countries - 34 out of 48 - experienced an increase in FDI. However, the overall rise was characterized by strong

fluctuations in FDI in channels, financial flows from corporate restructuring, and M & amp. For the regions, flows to North America, Europe, and other developed countries rose, while in the European Union, they declined (UNCTAD, 2022). At the state level, the United States of America topped the list of recipients of foreign direct investment (top 20 host economies) in 2022 with a value of \$367 billion, followed by China with a value of 181, Hong Kong with a value of 141, Singapore with a value of \$90 billion and Canada with a value of \$60 billion. For African countries, the list included one African State, South Africa, worth \$41 billion, in eighth place. the list included one Arab State, the United Arab Emirates, valued at \$21 billion and ranked penultimate (UNCTAD, 2022).

3. Overview of Algeria's investment laws

Algeria is one of the developing countries that have adopted different economic thoughts over two consecutive stages, adopting the socialist system based on the centrality of the decision and abandoned in exchange for the choice of the liberal system based on market rules. The two phases involve enacting a set of laws that are commensurate with each stage's variables and events.

3.1 Investment Laws in the Socialist Economy

This phase was characterized by the mechanisms of the targeted economy, during which a series of legal texts on the promotion of foreign investment was promulgated, as follows:

- Investment Act 1963

It was directed at foreign investors and foreign productive capital. It involved:

- Freedom of investment for natural and moral persons under the text of article three

- Freedom of movement and residence for the directors of these institutions.

- Investment Act 1966

Ordinance No. 99-594, containing an investment law attracting domestic private capital, was promulgated first. Second, foreign capital prevented foreign investors' intervention in specific sectors, most of which was an investment in vital sectors. The State and its bodies are now investing in it through mixed companies. A foreign investor can invest in other activities based on prior approval from the competent administrative authorities.

-National Economic Investment Law 1982

Act No. 95-33 on Investment, National Private Economy, addresses the role of the national private sector in economic development and permits investment in areas defined in article 33 thereof, namely:

- Industrial repair and maintenance of equipment and small and medium industries.
- Fishing and subcontracting activity, construction and public works, tourism and hotel business.
- Road transport of passengers and goods

Article 8 of the Act states that its purpose is to contribute to the expansion of national productive capacities, job creation and integration with the socialist sector by contributing to industrial transformation activities and participating in balanced regional development.

- Investment Laws in the Market Economy Phase

At this stage, Algeria adopted a series of framed and structured texts for the investment process, intending to enshrine the requirements of the new economic order and establish its rules.

- Monetary and Loan Act 90-10

The Monetary and Loan Act regulated the rules of the market economy, the regulation of the exchange market and the movement of funds, restructuring the Algerian banking system, and reorganizing banks and their role in investments. The Act enshrines a set of fundamental principles in the field of investment, which is an essential milestone in Algeria's legal history, by the actual change towards the establishment of an independent banking system, which serves the transition to a market economy.

- Ordinance No. 01-03 on investment development

This law emphasizes the principle of freedom of investment as a legal safeguard for the foreign investor, which reflects the special protection of its funds from outside Algeria.

In the administrative aspects of text No. 01-03, the foreign investor did not restrict in specific sectors where investment could be made because economic activities were not expressly reserved for the State, its branches, or any expressly designated legal person. Consequently, the concept of strategic sectors (e.g., oil, mines, telecommunications.) is dispensed.

Despite all the advantages of this text, it knew of a failure to attract foreign investment between 2009-2016, owing to amendments that affected the text through finance laws beginning with the 2009 Supplementary Finance Act, which included the adoption of rule 49/51 that affected the meaning of the freedom of investment.

- Act No. 16-09 on investment promotion

New text No. 16.09, on investment promotion, gave new impetus to Algeria's foreign investment process, particularly after insufficient Order No. 01-03 in attracting foreign investment and ensuring genuine legal protection of foreign capital, and was found to be overloaded with sovereign rules resulting from successive financial laws.

All of the laws above failed to build a solid base for Algeria's overall investment climate, demonstrating the exclusion of the foreign investor and its exclusivity in partnership contracts and enshrining rule 49/51 in favor of the domestic public investor in particular at the expense of the foreign investor as a minority partner.

3.2 Investment situation in Algeria

In recent years, foreign direct investment inflows to Algeria have declined compared to other African and Arab countries that do not possess Algeria's varied natural qualifications. Experts attribute this decline to Algeria's legal investment system, which many consider unattractive to other Arab and African States. In this context, FDI accounts for a small proportion of GDP, not exceeding 2% during the period 2005-2020 (UNCTAD, 2020). As shown in table 01.

Table 1: Foreign Direct Investment Inflows (millions of US\$)

year	2005	2010	2015	2020
FDI inflows	1145.62	2301.23	-584.54	1125.41
FDI outflows	-20.19	220.49	103.22	15.52
% of GDP	1.65	1.27	1.20	1.19

FDI outflows as % of GDP in 2020 = 0%

Source: UNCTAD. (2020). *UNCTADstat - General Profile: Algeria*.

Table 1 shows the decrease in foreign direct investment inflows, with a value of 1145.62 in 2005, after which it increased by 2301.23 in 2010, and after that sharply decreased in 2015 to a negative value equivalent to -584.54, owing to the application of rule 94/51 of the Supplementary Finance Act of 2009. The development of the number and cost of investment projects completed in Algeria during the period 2005-2021 can also be explained in table 2.

Table 2: Foreign direct investment to Algeria in the US \$1 million for the period 2005-2014

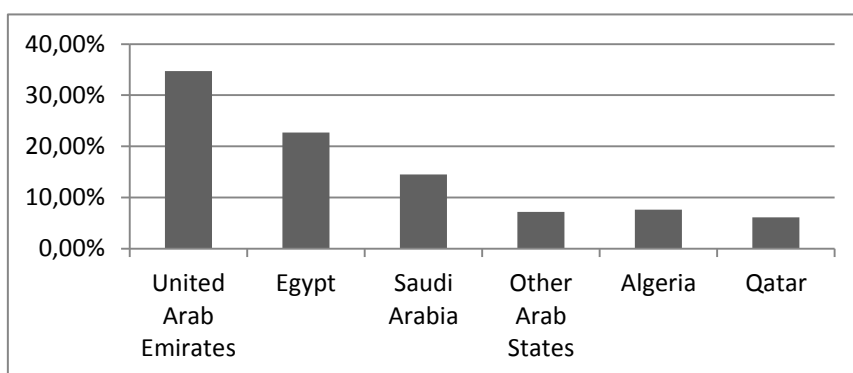
2005-2007	2008	2009	2010	2011	2012	2013	2014
1.513	2.594	2.746	2.264	2.571	1.499	1.691	1.488

Source: the Arab investment and export credit guarantee corporation" Dhaman". (2011-2014). *Arab Countries Investment Climate Report*.

There was a recovery in Algeria's foreign investment value during the period 2005-2011, from 1.513 in 2005 to 2.594 in 2008. 2.746 In 2009, 2.264 in 2010, and 2.571 in 2011. After that, the value fell in 2012 to 1,499 and remained almost stable at the end of 2014.

On the other hand, Algeria was one of the most important Arab countries to receive OECD investments in 2005-2014, as shown in figure 01.

Figure 01: Top Arab countries receiving OECD investments (2005-2014)



Source: by researchers based on: the Arab investment and export credit guarantee corporation" Dhaman". (2016). *Arab Countries Investment Climate Report* (p. 74).

In figure 01, the United Arab Emirates topped the Arab countries receiving OECD investments with 34.71%, followed by Egypt with 22.67%. Saudi Arabia ranked third at 14.47%, after which the rest of the Arab countries came at 7.15%. Algeria ranked fifth at 7.64%, then Qatar at 6.11%.

This relative improvement in the case of foreign investment is due to applying the articles of Ordinance No. 01/03 on investment development.

Algeria seeks to attract foreign investment in many sectors through the reforms it has adopted within the framework of development programs to improve the investment climate and reduce the complexities facing foreign investors. Algeria has adopted such reforms to create added value for the national economy and be an attractive pole for various investments.

In 2016, Act No. 16-09 on investment development was promulgated as an attempt by the Algerian authorities to attract more foreign investment through tax benefits and incentives provided for by this Act. Table 03 shows the evolution of Algeria's foreign investment value after applying Act No. 16-09 during the period 2015-2020.

Table 3: Foreign direct investment to Algeria in the US \$1 million for the period 2015-2021

2015	2016	2017	2018	2019	2020	2021
-587	1.546	1.203	1.466	1.381	2.723	1.050

Source: the Arab investment and export credit guarantee corporation "Dhaman". (2015-2021). *Arab Countries Investment Climate Report*.

Notes also the constant value of foreign direct investment to Algeria during 2015-2021.

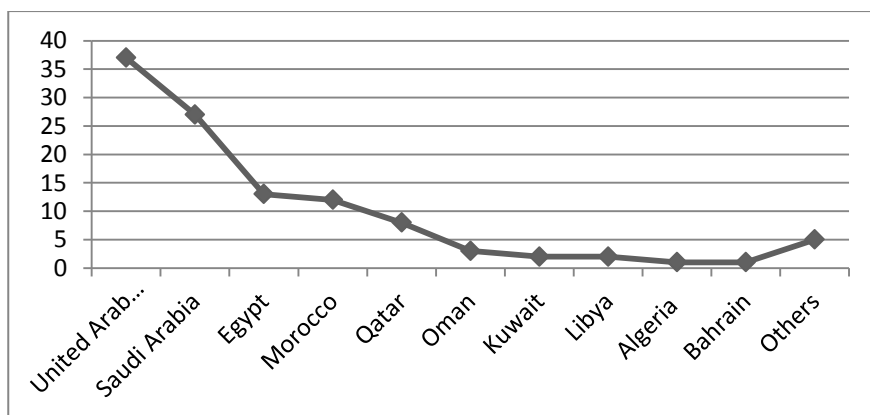
Experts attribute the decline in foreign investment in Algeria to Partnership Rule 51/49. Algerian legislation had taken a mandatory form of investment in a partnership between a foreign investor and a local partner.

This investment depends on the financial contribution, provided that the majority of the local partner is 51% and 49% of the foreign investor. Therefore, partnership rule 51/49 can also hinder attracting investments and foreign nationals to Algeria, negatively affecting the business climate and the principle of equality and non-discrimination among investors.

Although Law No. 16-09 came with advantages, incentives, and exemptions, it consecrated rule 49/51 and thus failed to improve the investment climate and modernize the investment's legislative environment.

Figure 2 shows that Algeria last ranked in the list of Arab countries receiving foreign investment during the first quarter of 2021, showing the investment cost of projects, while Figure 3 shows the number of investment projects.

Figure 2: Number of foreign projects coming to Arab countries in 2021



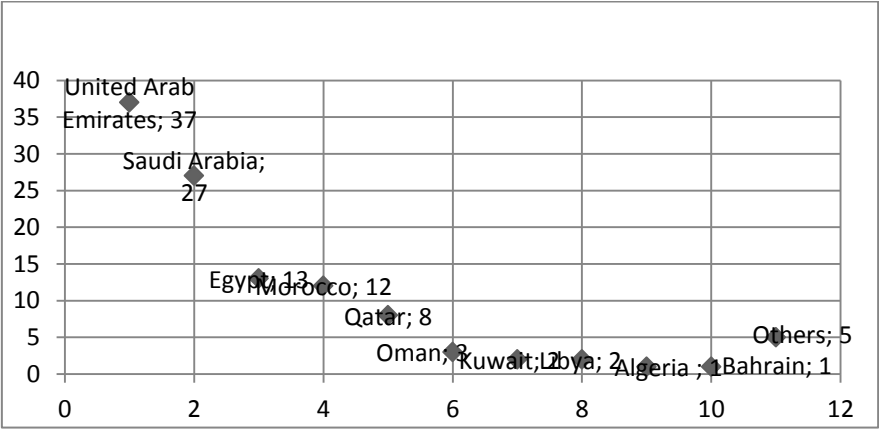
Source: by researchers based on: Ltd, W. (2021). *fDi Markets: The in-depth crossborder investment monitor from the Financial Times*. Retrieved May 30, 2022, from <https://www.fdimarkets.com/>

Figure 2 shows that Egypt ranked first in the list of Arab countries in terms of the investment cost of the investments it received worth

\$2261.7 million. Saudi Arabia ranked second at \$1877.8 million. The United Arab Emirates ranked third at \$598.7 million, followed by Morocco at \$380.7 million.

Algeria had achieved a low cost of US \$10.5 million, confirming foreign investors' reluctance to invest in Algeria because of the inconsistent terms described by some, which had significantly affected investment values.

Figure 3: Number of foreign projects coming to Arab countries in 2021



Source: by researchers based on: Ltd, W. (2021). *fDi Markets: The in-depth crossborder investment monitor from the Financial Times*. Retrieved May 30, 2022, from <https://www.fdimarkets.com/>

During the first quarter of 2021, Algeria received only one foreign investment project, compared to 37 in the United Arab Emirates, 27 in Saudi Arabia, 13 in Egypt, and 12 in Morocco. Previous statistics indicate an unattractive investment climate in Algeria.

**Table 4: The number of jobs generated by foreign companies
(2018, 2020, and 2021)**

Year	2018	2020	2021
Number Of Posts	10.349	251	14
Number Of Companies	17	6	1

Source: by researchers.

Table 4 shows the decrease in the number of jobs provided by FDI due to the decrease in the number of foreign-invested companies, with only six companies in 251 positions in 2020, compared to 10,394 positions in 2018, where 17 foreign companies were .In 2021, only 14 positions were created, with only one investing company.

In the light of the low value of the investment received in Algeria, the Algerian authorities have attempted to produce a legal text that would help to improve the business climate and create conditions conducive to the liberalization of the spirit of initiative and the diversification of the national economy consistently and comprehensively.

The new Investment Bill introduced three stimulus regulations for priority sectors Areas to which the State attaches particular importance, as well as the stimulus system for structured investments. According to the bill, the stimulus system for priority sectors is called the sector system. The stimulus system for areas to which the State attaches particular importance is called the "zone system". A structured investment incentive system is called a structured investment system.

This Act contains several fundamental amendments to previous laws, which can be summarized as follows:

- Strengthen safeguards on the enshrinement of the principle of freedom of investment.
- Strengthen the legal system to protect investors from bureaucratic arbitrariness by establishing an independent,

high-level mechanism comprising judges, economists and financial experts, to be drawn up by the Presidency of the Republic and to deal with complaints and appeals filed by investors.

- Place (the Algerian Investment Promotion Agency) under the authority of the Chief Minister.
- Placement of representatives of various sectors appointed to the only Windows, with the Algerian Investment Promotion Agency authority to make all investment decisions.
- Abandon the manifestations of bullying and control in the processing of investors' files, and reduce the duration of their study to less than a month while adopting international standards in attracting investments, focusing on speed, efficiency and durability.
- It supports investments that reduce the import bill and depend on local raw materials.

4. Conclusion

This study analyzed Algeria's investment climate through a review of the totality of laws and successive legal texts that have formed the basis of the regulatory environment for many years and, given the inability of these laws to provide freedom to foreign investors and to establish the rules of private initiative, In order to take advantage of investment opportunities after foreign companies' reluctance to invest in the Algerian market, especially in the energy sector and even in other vital sectors such as tourism, agriculture and mines, which the Algerian authorities have relied on as an alternative to monopolizing oil revenues for six decades.

This study has reached the following findings:

- Many laws on foreign direct investment (FDI) have been promulgated, and each is suited to the economic approach the

Algerian authorities chose to formulate their development plans and public policies.

- Ordinance No. 01/03 is the first legal text to conform to the rules of the market economy, which became the basis of Algeria's development programmes after the oil crisis of 1986. It was designed to liberalize the private initiative and ease restrictions on foreign direct investment.
- Order 01/03 was loaded with tax benefits to encourage investors, thus making Algeria one of the most important Arab countries receiving foreign direct investment from the OECD group.
- Some articles of Ordinance No. 01/03 have been amended by supplementary financing laws, which have been considered to be an impediment to FDI owing to the instability and consistency of investment laws, and there is a reservation to rule 94/51, which foreign investors have deemed to impede investment freedom and restrict business space.
- The years of application of rule 94/51 saw a perceived decrease in the value of investments received in Algeria, which led the Algerian authorities to bring about a radical change in investment laws beginning in 2022.

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